CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
CORPORATE GOVERNANCE INVESTMENTS

May 14, 2007

This Policy is effective immediately upon adoption and supersedes all previous Corporate Governance Investment policies.

This Policy applies to the Corporate Governance Program and is applicable on a global basis covering both developed and emerging markets. This Policy has two parts: Externally Managed and Co-Investment. The Externally Managed part covers investment in externally managed corporate governance funds. The Co-Investment Strategy part covers an internally managed active corporate governance equity program.

EXTERNALLY MANAGED

I. PURPOSE

This document sets forth the investment policy ("the Policy") for Global Equity, with respect to Corporate Governance Fund Investment Vehicles ("Corporate Governance Funds"). In addition, this Policy applies to those Investment Vehicles enumerated in Section V.B. The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with Corporate Governance Funds.

II. STRATEGIC OBJECTIVE

Broadening the opportunity set of the System's investment portfolio for achieving investment returns not available in traditional public markets investments is the strategic objective of investments in Corporate Governance Funds.

Corporate Governance Funds shall be selected to accomplish the following:

A. Diversify the System's Global Equity Program.

B. Enhance the System's long-term total return.

C. Hedge against active member (pre-retirement) liabilities.

D. Enhance the System's Corporate Governance Program.

E. Consider solely the interest of the System's participants and their beneficiaries in accordance with California State Law.

III. RESPONSIBILITIES

A. The **System's Investment Committee** ("the Investment Committee") is responsible for approving and amending this Policy.

B. The **System's Investment Staff's** ("the Staff") duties include, but are not limited to, the following responsibilities:

1. Developing and recommending this Policy to the Investment Committee.

2. Developing and maintaining a procedures manual, subject to periodic reviews and updates, outlining Staff operational procedures used in implementing this Policy.

3. Implementing and adhering to this Policy.

4. Evaluating and selecting, Corporate Governance Funds.

5. Obtaining equity stakes in management firms under this strategy, where appropriate.

6. Monitoring selected Investment Partner(s) to determine if the partners' actions and investment results are consistent with the System's manager monitoring policies.

7. Reporting to the Investment Committee the following:

   a. Concerns, problems, material changes, and all violations of Policies immediately and in writing, along with explanations and appropriate recommendations for corrective action.

   b. A quarterly report listing Corporate Governance Fund investments in emerging market Corporate Governance Funds.

c. A comprehensive formal review of the Program at least every three years.

C. The **Corporate Governance Fund** is responsible for all aspects of portfolio management as set forth in the investment partner's contract with the System and shall fulfill the following duties:

1. Communicate with Staff as needed regarding investment strategy and investment results. The investment partner(s) is expected to monitor, analyze, and evaluate performance relative to the agreed-upon benchmark.

2. Cooperate fully with the System's Staff, Custodian, Corporate Governance Fund Administrator, and General Pension Consultant on requests for information.

3. Comply completely with the System's mandated reporting requirements, including but not limited to, accounting for fees, expenses, capital investments, and dispositions.

D. The **General Pension Consultant** duties include, but are not limited to the following:

1. Monitoring the activities of corporate governance funds.

2. Evaluating performance relative to individual benchmarks and this Policy.

3. Reviewing the efficacy of the Corporate Governance Program on a continuous basis.

4. Due diligence and independent recommendations on prospective Corporate Governance Funds will be provided by either the General Pension Consultant or another approved Investment Office Consultant. The consultant shall be selected by the Senior Investment Officer, in conjunction with the Chief Investment Officer.

a. A favorable due diligence report and opinion letter is required before an investment can be made in an emerging market corporate governance fund.

IV. PERFORMANCE OBJECTIVE

Corporate Governance Funds are highly specialized investments; therefore, the System shall establish performance objectives for each individual Corporate Governance Fund. These objectives shall be set at levels that are consistent with the strategy employed by the fund manager.

V. INVESTMENT APPROACHES AND PARAMETERS

A. Approach

1. Corporate Governance Funds shall be alternatives to other traditional active management vehicles in the Public Markets. Funds for investment in Corporate Governance Funds may come from the active or passive management allocation in each asset category. Corporate Governance Funds shall not exceed twenty-five percent of the total active management allocation on a market value basis in each asset category.

2. The Program shall use Corporate Governance Funds opportunistically to gain the attractive risk-to-reward characteristics of specialized and unique investment strategies. Corporate Governance Funds are not intended to be a substitute for investment strategies generally available in standard agency agreement format.

3. In all instances where an Advisory Board is present at a Corporate Governance Fund, CalPERS will seek membership in order to provide oversight and counsel regarding the Fund's operational, investment, and corporate governance activities.

   a. For Funds investing in developed and emerging markets, every effort will be made to ensure Advisory Board activities are consistent with CalPERS' Principles for Accountable Corporate Governance.

   b. For Funds investing in developed and emerging markets, every effort will be made to apply the United Nations Principles for Responsible Investment.

4. The Program shall implement Corporate Governance Funds through partnerships, closed-end funds, or other formation structures, e.g., limited liability companies (LLCs), where the

general partner(s) or fund manager(s) have expertise in the specified mandates and in related areas material to the success of each investment strategy. The justifications for a limited partnership or LLC structure include, but are not limited to, the following:

a. Financial Firewall: The limited liability of a partnership or LLC arrangement is important since Corporate Governance Funds sometime use derivatives and leverage. The System, as a limited partner, has the benefit of this limited liability.

b. Access Unique Approaches with Limited Liquidity: The key to successful Corporate Governance Fund investing is in selecting vehicles where the specialization of the investment is sufficiently unique that the partnership or LLC structure is justified in limiting asset growth in the strategy, ensuring a proper investment time horizon, and protecting the System from the vagaries of other investors who may not be like-minded. The fees and expenses of investing in Corporate Governance Funds may be higher than traditional active management. The System shall not fund Corporate Governance Funds that simply invest in traditional active management approaches at higher fees.

c. Access Unique Talent: The specialized and focused nature of Corporate Governance Funds often requires more specialized investment skills than those needed for traditional active management. Some of these investment professionals manage money only in the partnership format or LLC structure.

5. The negotiation of terms in Corporate Governance Funds shall protect the interests of the System, and shall address at a minimum the following issues:

a. Alignment of Interests: Corporate Governance Funds terms including fees shall be negotiated to ensure the alignment of interest with the System. The management fee, carried interest, performance objective, return of capital, lock-up period, clawbacks, and other relevant terms shall protect the System in the event of adverse performance results, while ensuring that the limited liability status is maintained.

Where appropriate, a return of capital commitments shall be negotiated.

b. Leverage: It is recognized that Corporate Governance Funds may expose the System's assets to leverage, meaning that a fund's market exposure may exceed the market value-adjusted capital commitment by the amount of borrowed capital. Negotiation of corporate governance investment vehicle terms shall consider the System's stated corporate governance level of leverage necessary for achieving the investment's stated objectives without exposing the System to undue risk. The partnership or LLC agreements shall detail the amount of leverage and monitor leverage on a case-by-case basis and in the aggregate, to ensure that expected and realized returns are sufficient and achievable to compensate for the risk incurred. For the Corporate Governance Funds, the limit on leverage shall not exceed 100% of the existing capital without prior Investment Committee approval.

c. Reporting Requirements: To appropriately account for fees, individual expenses, invested capital, and any other items affecting the investment, Staff shall prescribe a standard reporting format, which all the General Partners shall follow.

B. Investment Selection

1. Corporate Governance Funds may be selected if they enhance the investment program in order to achieve the overall asset class investment goal. Corporate Governance Funds may include investments in developed and emerging equity and fixed income asset classes in strategies that may include, but are not limited to, the following areas but must be subject to asset class restrictions:

   a. Relative Value Funds;

   b. Market Neutral Funds;

   c. Arbitrage Funds;

   d. Derivative-Based Strategy Funds;

   e. Concentrated or Strategic Block Funds; and

f. Crossover Funds (where public securities and private investments are included in the partnership).

2. The Staff shall develop and maintain selection guidelines for Corporate Governance Funds to include the following:

   a. Minimum requirements with respect to the following:

      (1) General Partner Investment Experience;

      (2) Basic Investment Vehicle Terms;

      (3) Investment Goals and Objectives; and

      (4) Degree of Leverage.

   b. Performance Criteria

   c. Due Diligence Process

   d. Legal Constraints or Requirements

   e. Reporting Requirements

   f. Quality control processes including, but not limited to, investment monitoring and risk control

   g. Other relevant parameters that may apply

3. Staff shall review opportunities to obtain an equity stake in Corporate Governance Fund managers and make recommendations to the Investment Committee as appropriate. A separate portfolio will be established to provide for performance measurement of CalPERS' equity stakes in Corporate Governance Fund managers.

C. Investment Parameters

Corporate Governance Funds shall operate under a limited partnership agreement, limited liability (LLC), closed-end fund or other similar legal structure. Corporate Governance Funds include, but are not limited to, strategic block investment funds or crossover funds where the underlying investments consist of both public and private investments.

All legal structures shall include specific, written investment guidelines. The guidelines shall outline the fund's investment philosophy and approaches, representative portfolios characteristics, permissible and restricted securities and procedures, and a performance objective commensurate with the investment risk to be incurred.

Implementation of this Program shall comply at all times with the applicable System investment policies.

VI. BENCHMARKS

Due to the wide range of markets in which these investments shall be made, appropriate benchmarks shall be established for each specific Corporate Governance Fund. They shall reflect the investment opportunity set or risk profile of each investment. These benchmarks shall be established prior to investment and shall be documented with each corporate governance fund manager.

VII. GENERAL

Investors, managers, consultants, or other participants selected by the System shall make all calculations and computations on a fair-market-value basis as recorded by the System's Custodian. In the case of private investments, calculations and computations shall be made consistent with the partnership agreement, unless otherwise approved by the Investment Committee.

VIII. GLOSSARY OF TERMS

Definitions for key words used in this policy are located in the Equity Glossary of Terms which is included in the System's Master Glossary of Terms.

CO-INVESTMENT STRATEGY

I. PURPOSE

This section sets forth the investment policy ("the Policy") for the Co-Investment Strategy ("the Program"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with the Co-Investment Strategy.

II. STRATEGIC OBJECTIVE

Broadening the opportunity set of the System's investment portfolio for achieving investment returns in developed and emerging markets not available in traditional public markets investments is the strategic objective of the Co-Investment Strategy.

The Program shall be managed to accomplish the following:

A. Diversify the System's Global Equity Program.

B. Enhance the System's long-term total return.

C. Hedge against long-term liabilities.

D. Enhance the System's Corporate Governance Program.

E. Consider solely the interest of the System's participants and their beneficiaries in accordance with California State Law.

III. RESPONSIBILITIES

A. The **System's Investment Committee** ("the Investment Committee") is responsible for approving and amending the Policy.

B. The **System's Investment Staff's** ("the Staff") duties include, but are not limited to, the following:

1. Developing and recommending the Policy to the Investment Committee.

2. Developing and maintaining a procedures manual, subject to periodic review and updating, that outlines Staff operational procedures used in implementing this Policy.

3. Implementing and adhering to the Policy.

4. All aspects of portfolio management including monitoring, analyzing, and evaluating performance relative to the appropriate benchmark. In managing the Co-Investment Strategy, staff will work cooperatively with external partners specific to each investment. Staff will be responsible for identifying potential partners.

C. The **General Pension Consultant** (the "General Pension Consultant") is responsible for monitoring and evaluating the program's performance relative to the applicable benchmark and the Policy. The General Pension Consultant shall report to the Investment Committee on a quarterly basis, in accordance with its contract.

IV. PERFORMANCE OBJECTIVE

The Co-Investment Strategy is expected to outperform the benchmark on an annualized basis by at least 200 basis points. The benchmark for each co-investment with an external partner will be the same as that for the external partner’s main portfolio. Due to the concentrated nature of the Co-Investment Strategy, it is expected to have a higher overall risk level.

V. INVESTMENT APPROACHES, SELECTION, AND PARAMETERS

A. Approaches

1. CalPERS’ Co-Investment Strategy will be an internally managed active equity program based on fundamental analysis and corporate governance. The portfolio will take concentrated positions in selected developed and emerging market companies. Combined positions between CalPERS and its external partner may not exceed 25% of a company’s market capitalization without prior Investment Committee approval.

2. The Program will be implemented in partnership with external managers. Each investment will be made under a letter agreement with a partner, such that the partner will be required to take a significant equity position consistent with CalPERS’ stake.

3. The Co-Investment Strategy will focus on unlocking intrinsic value in under-performing, publicly traded companies on a global basis. The companies will have a generally strong fundamental business model, but are under-performing their peers due to management or board related issues. In cooperation with our external partner, CalPERS' staff will work with the company's management, Board of Directors, and other shareowners to build a consensus identifying the deficiency and the means to correct it.

    a. Tactics employed to address under-performing companies, in developed and emerging markets, will be consistent with CalPERS' Principles of Accountable Corporate Governance.

    b. Tactics employed to address under-performing companies, in developed and emerging markets, will be consistent with the United Nations Principles for Responsible Investment.

B. Investment Selection

1. Staff has developed a successful investment process to govern the way co-investments are made in the Portfolio. Companies that are candidates for co-investment will have the following characteristics:

    a. Considered one of the best ideas in the manager's portfolio.

    b. An underperforming security and company.

    c. Stock price is selling below the embedded intrinsic value.

    d. Manager has a strategy in place to unlock the intrinsic value.

    e. Holding additional shares in CalPERS' Co-Investment portfolio will help the corporate governance managers effect the desired operational and governance changes.

2. Upon receipt of a co-investment proposal from an external corporate governance investment manager, staff will conduct

independent research and analysis to be used in the evaluation of each proposed co-investment. Staff will consistently conduct due diligence using the following steps:

a. Conduct a complete review of all documentation provided by the external corporate governance manager acting as the source for the co-investment idea. The purpose of this step is to understand the investment case being made by the manager, gain knowledge about the strategy for unlocking value embedded in the company as well as assess the potential risk and reward associated with the proposed co-investment.

b. Assess the incremental benefit to the manager's strategy of CalPERS taking a co-investment position. The co-investment strategy must have merits beyond giving the manager capital in their original strategy.

c. Apply the CalPERS Focus List screening criteria to analyze the company under consideration. This process will allow staff to incorporate an additional perspective for evaluating the opportunities to improve the company's corporate governance practices, operation and financial performance and assess potential improvements in these factors.

d. CalPERS Risk Management system will be used to assist in identifying the impact the proposed co-investment will have on the risk characteristics for the Co-Investment Portfolio and the Total Fund.

e. The Senior Investment Officer for Global Equity will make all buy and sell decisions in accordance with delegations granted by the Investment Committee. This decision making process will be supported by the recommendation from the external investment manager, research provided to staff by the external investment manager, staff's independent research, industry analysis, the Focus List Program screening process and input from the CalPERS Risk Management System.

C. Document Retention

All documentation for a proposed and actual co-investment will be maintained in the Corporate Governance Office for three years. After three years, all documentation will be moved to an offsite location. Documents retained will include and not be limited to (1) research received from the external manager proposing the co-investment, (2) industry analysis report, (3) company report consistent with the Focus List process, (4) research reports received from a third party, (5) reports from the CalPERS Legal office.

D. Letter Agreements

A Letter Agreement for each co-investment will be executed between the external corporate governance manager and the CalPERS Legal office before trading in the stock of the proposed co-investment can begin. The Letter Agreement notes the specific terms and conditions for the co-investment relationship between CalPERS and the external corporate governance investment manager. Specifically, the Letter Agreement will identify the proposed co-investment company, applicable performance objective and benchmark, and method for calculating incentive fees to be paid to the investment manager if performance objectives are met. Fees associated with co-investments will generally not include the base management fee and may have a lower incentive fee reflecting the fact that there are no incremental costs to the manager as a result of CalPERS buying additional shares.

E. Trading

Upon execution of the Letter Agreement, staff will coordinate trading with the external manager and execute trading in the shares of the co-investment target through the CalPERS Global Equity Trading Desk (“Desk”). Staff will notify the Desk of the co-investment target and the external manager tied to the specific co-investment to be traded. The Desk will communicate with the external manager to gain market intelligence that will contribute to achieving “best execution” for both purchases and sales of the shares of the co-investment target. For co-investment in non-US equity securities, a non-US dollar currency may be required to execute the trade. In conjunction with the Desk, staff will coordinate with the currency management staff.

Staff will use a template to provide consistent and accurate information about the co-investment target to the Desk. The template will specify the name of the co-investment target, the quantity of shares to be traded, the type of transaction to be executed, the type of order being submitted for execution (i.e. market order, limit order, etc.), and the specific currency denomination required for the trade. Additional trading instructions (verbal or written) may be given to the Desk by the Portfolio Management staff. Information contained in the trading template will also be used by the Desk for compliance checks and to facilitate the settlement of trades. The Desk will apply all of its record management requirements to documentation pertaining to trading in co-investment.

F. Regulatory Reporting Requirements

Staff will maintain compliance with regulatory reporting requirements such as those that fall under the group rules for purposes of Securities and Exchange Commission (SEC) Regulation 13(d) and will have filing requirements under this Regulation. In the unusual circumstances where filing requirements are potentially harmful to the strategy being employed to unlock the intrinsic value embedded in a company, staff in coordination with the legal office may deem it financially more advantageous to temporarily relinquish CalPERS' proxy voting rights in a co-investment.

An alternative to relinquishing CalPERS' proxy voting rights from time to time on specific securities is to closely monitor the size of portfolio holdings to be sure that CalPERS stays well below the threshold that triggers SEC filing requirements and deliberately limit the size of CalPERS' co-investment position.

G. Reporting to the Investment Committee

Wilshire Associates will include the Program in its quarterly performance report to the Investment Committee. Each co-investment will be maintained and accounted for in a separate account tied to the external manager providing the co-investment recommendations. The performance benchmark for the investment manager providing the co-investment will be the same as its respective Portfolio. This methodology will provide full disclosure and transparency to the Investment Committee on performance pertaining to each co-investment partner and their respective Portfolio. The performance for the entire Program will be the dollar-weighted average of the total return for each Portfolio associated with a specific external investment manager.

H. Annual and Quarterly Reports to the Investment Committee

In addition to reports provided on the Program to the Investment Committee by Wilshire Associates, staff will provide the Investment Committee with an annual review in the form of an annual agenda item similar to what the Committee receives regarding the MDP Program. Staff will also provide the Investment Committee with a Quarterly Review Executive Summary to address portfolio activity, performance, and significant events.

I. Allocation of Capital

Staff will allocate capital in accordance with delegations granted by the Investment Committee.

J. Investment Criteria

1. The corporate governance external manager's portfolio total return should exceed that for their specific benchmark since inception.

2. Allow investments on a global basis recognizing any other CalPERS Investment Policies that impact the universes of available public equity.

VI. BENCHMARKS

The benchmark for each co-investment with an external partner will be the same as that for the external partner's main portfolio. The benchmark for the co-investment strategy is the portfolio market value weighted total return for the benchmark for each external partner with whom an actual co-investment has been made. The total return for the co-investment strategy will equal the portfolio market value weighted total return for each investment.

VII. GENERAL

Staff, consultants, or other participants as appropriate shall base all calculations and computations on market value as recorded by the Systems' Custodian.

VIII. GLOSSARY OF TERMS

Definitions for key words used in this policy are located in the Equity Glossary of Terms which is included in the System's Master Glossary of Terms.

Internal Relational Program
Approved by the Policy Subcommittee: March 15, 2002
Adopted by the Investment Committee: April 15, 2002
Revised by the Policy Subcommittee: December 10, 2004
Adopted by the Investment Committee: February 14, 2005

Corporate Governance Investment Vehicles – Externally Managed
Approved by the Policy Subcommittee: June 10, 2005
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Revised by the Policy Subcommittee: September 16, 2005
Adopted by the Investment Committee: October 17, 2005

Name Change to Corporate Governance Investments
Revised by the Policy Subcommittee: October 16, 2006
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